



Australian Mining Assets – the need to review values

Five reasons why a review of insured values in the Australian mining sector is important now

John Foord undertake a significant number of mining asset valuations globally. One of the major challenges with the assessment of these assets, especially given the often-remote locations, is the correct approach to assessing the “replacement cost” for insurance purposes.

Australia has some unique challenges and there are a number of reasons why existing sums insured may need a detailed review in the current climate:

1 Capital investment in the mining sector has changed significantly over recent years and EPC margins will have fluctuated rapidly as a result.

2 The impact of Covid and connected changes in global supply chains has increased equipment costs, as well as lead times.

3

Foreign exchange movements, and significant changes in global logistics costs are impacting costs for overseas sourced assets.

4

Commodities integral to mining facility costs such as steel have seen unprecedented cost increases in 2020/21.

5

Insurance policy terms, particularly average clauses and inclusions / exclusions, are being changed as insurers seek to reduce losses.

“Our previous insured values were based on original construction costs which included old mine development costs. Had it not been for John Foord, we would have got ourselves insured incorrectly as our insurance policy included redundant workings costs!”
– Risk Manager, Mining Client

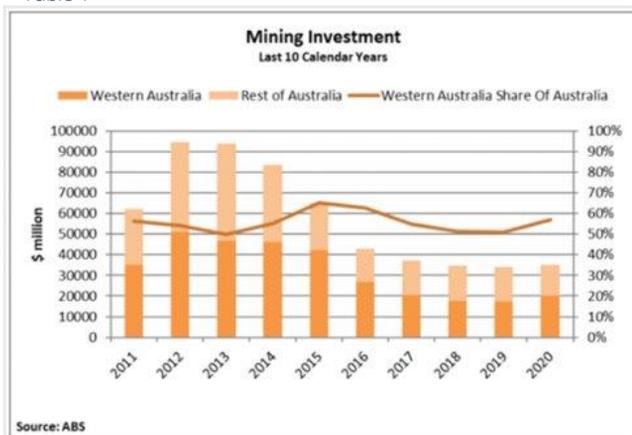


According to the Australia Bureau of Statistics (ABS), mining capital investment has declined over recent years.

With investment having decreased significantly since the peak during 2012 to 2014 it is likely that construction capabilities are available that could lower EPC and EPCM contract costs compared to these previous peaks in investments.

The following chart (Table 1) from ABS indicates this change in mining investment over the last decade:

Table 1



However, replacement cost are influenced by a number of factors, not just contractor margins.

Assessing current costs is more challenging than ever with global supply chains being disrupted by travel restrictions, trade disputes, changing government priorities, and shifting market demand.

The latest comments from central banks around the world indicate that they foresee continued challenges to economies for the next 12 months.

Accordingly, economists see continued low inflation for the remainder of 2021 and into 2022. This supports the general concept that prices should be stable or under downward pressure.

In practice, reduced capacity/production from suppliers, and continued disruption through rolling lockdowns, has meant that costs have shown upward pressure. Supply of construction materials and equipment has been particularly constrained and as a consequence these costs are rising more rapidly than general prices. This will have a knock on effect on mining reconstruction costs.



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So how have costs changed over recent years?

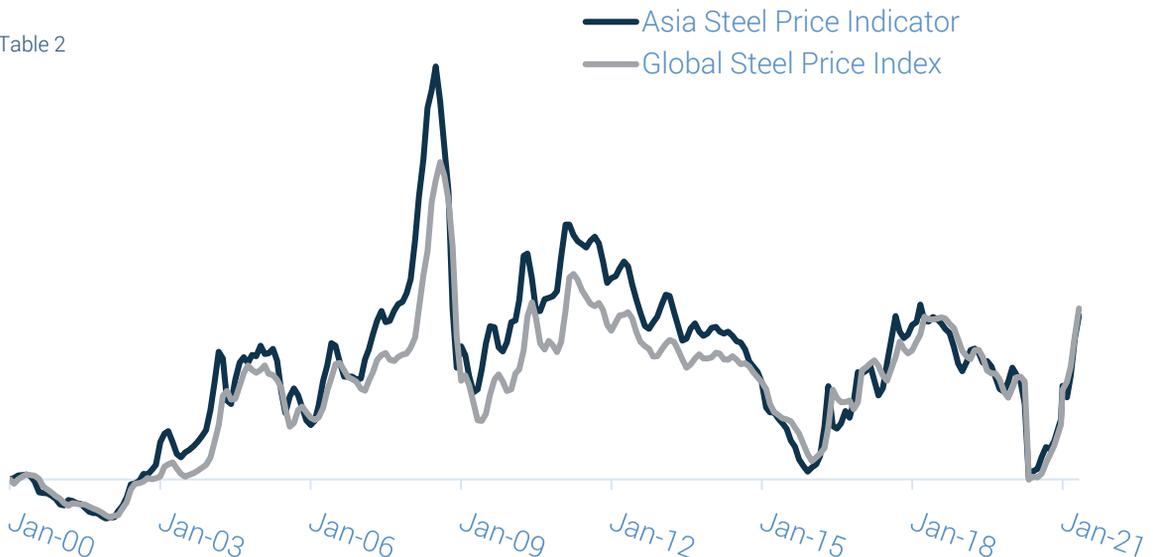
Many commodity prices have increased rapidly in recent months and there is no question this will have a knock-on effect on construction and 'factory gate' prices for goods. Table 2 below indicates how the price of one commodity, steel, has changed globally and across Asia.

These large increases over the last 12 months have been seen in other commodities, e.g., US cement prices were up a staggering 400% in the 12 months up to March 2021.

Besides the price rises in commodities, there have been changes in shipping, foreign exchange rates and supply chains that have all translated into a changed construction environment than 2 or 3 years ago.

Table 3 on the next page shows how building construction costs have changed over the last two decades. To note is the significant difference in Heavy and Civil Engineering construction costs, which would include mining projects, over the last two years compared to national building cost movements.

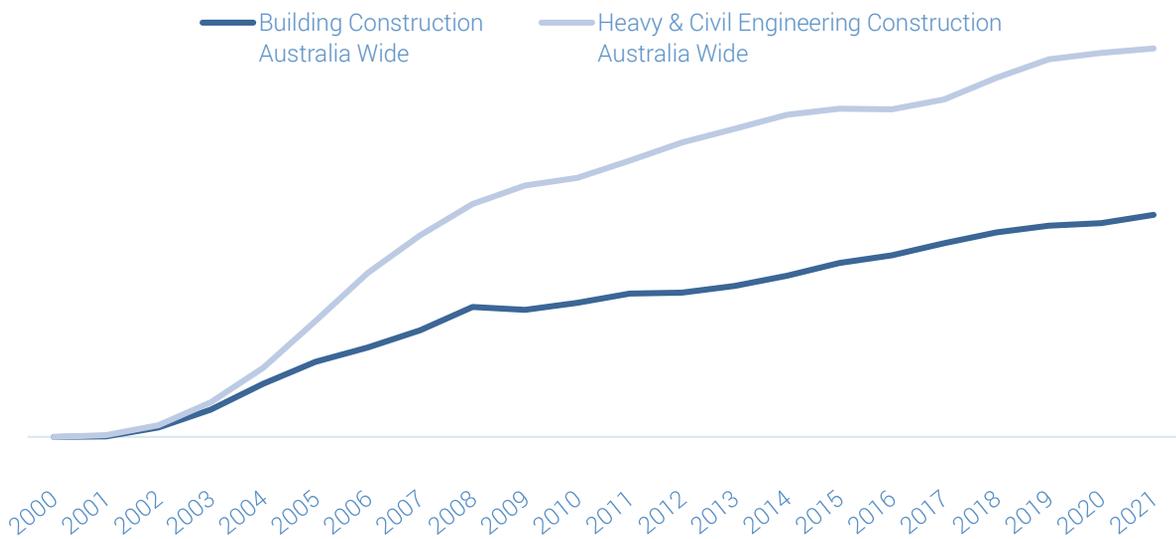
Table 2



The recent flurry of national budgets around the world announcing increased capital expenditure is likely to have a tangible impact on asset prices over the next 12 months and beyond. This could have unforeseen consequences to asset owners and insurers.

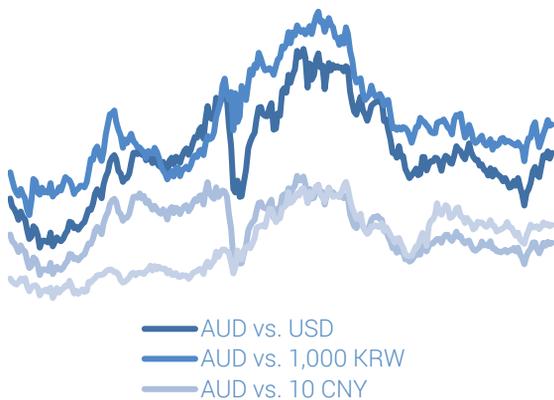


Table 3



FX movements have also had an influence on costs as can be shown by the chart below.

Table 4



The recently announced international government infrastructure investments will undoubtedly tie up large amounts of resources in terms of materials, labour and consultants, which could make it much more expensive for the private sector to undertake large projects in areas like mining, energy, and infrastructure.

Finally, there is an increased demand from insurers for extensive and accurate independent information on values at risk during policy renewals and after losses, making this issue more important than ever for risk managers.

Case Study #1

A major company owning underground and overground mines needed reliable and accurate value at risk figures to insure their assets. The mine had been developed over several decades meaning that the distinction between redundant equipment/workings and current operations was not totally clear from financial records. There was also confusion over the treatment of tailings and associated facilities in the event of a loss. Given the remoteness of the location the mine had also invested in roads and other infrastructure that had reverted to local government control.

John Foord Approach

We worked with the client to understand which areas of the mine were currently active and would need to be replaced in the event of a loss, so reducing their need to insure several redundant areas. Our team also undertook in-depth research on the tailings dams and the required scenarios in the event of reinstatement. Using this approach, we were able to provide the client with an overview of the components that made up the insurable values as well as constraints that must be taken into consideration.

Case Study #2

A client had not carried out a review of their sums insured for several years for a large number of mines, instead basing their declared values each year on indexing historic costs using a national producer price index and adding for capital expenditure.

John Foord Approach

We carried out a detailed assessment and considered rebuild costs using current equipment and construction costs using modern construction and technology. Using these techniques, we were able to present accurate and justifiable replacement values that included for the mine equipment and structure elements.

In the end, much of the capital expenditure was replacement of existing assets so the client had inflated the sums insured by applying this method.

Importantly actual construction and equipment costs in the mining sector had greatly exceeded national producer price growth and the client was significantly under-insured as a consequence.

About John Foord

Founded in London in 1828, John Foord specialises in the valuation of plant, equipment and property. As an independent advisory firm, we support clients across 45 countries and value assets exceeding \$100 billion US dollars per annum.

- Our services are used by leading insurers, reinsurers, brokers, asset owners and financiers across sectors internationally
- Our team consists of highly qualified industry specialists with valuation, surveying and engineering backgrounds

To find out more: enquiries@johnfoord.com

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